

Review of Internal Control Over Financial Accounting
For Debt Recoveries
Report No. 00-16, September 29, 2000

This report presents the results of the Office of Inspector General's (OIG) review of internal control over financial accounting for debt recoveries at the Railroad Retirement Board (RRB).

The RRB is an independent agency in the executive branch of the Federal government. The RRB administers the health and welfare provisions of the Railroad Retirement Act (RRA) which provides retirement-survivor benefits for eligible railroad employees, their spouses, widows and other survivors. The RRB also administers the Railroad Unemployment Insurance Act (RUIA) which provides unemployment and sickness insurance to workers in the rail industry.

Our review determined that internal control over debt recovery accounting is not adequate to ensure the reliability of financial reporting and the safeguarding of accounts receivable. We identified errors in the recording of debt recovery transactions that include:

- returned benefit payments that were not credited to debtor accounts;
- benefit payments that had been erroneously credited to debtor accounts as recoveries;
- delayed recording of certain RUIA debt recoveries; and
- abnormal balances in the general ledger unapplied cash accounts.

An examination of these errors identified weaknesses in the related internal controls. The present internal control structure, as it relates to debt recovery accounting, does not:

- provide for the establishment, review and reconciliation of controlling accounts in the general ledger;
- include reviews of all systems output; and
- adequately safeguard assets.

In addition, the present internal control environment does not provide management with sufficient information concerning the number and value of non-conforming transactions to provide the basis for an evaluation of potential financial impact.

We have made specific recommendations for corrective action to strengthen internal control in the areas of weakness identified by the audit. We have also recommended that the Bureau of Fiscal Operations organize a cross-organizational workgroup to study the debt recovery control environment and make recommendations for further improvement.

In response to our recommendations, management has agreed to take either the OIG's recommended corrective action or has proposed an alternative. However, management disagreed with the OIG's assessment that the errors, omissions and weaknesses in the RRB's system of internal control over debt recoveries constitute a reportable condition for purposes of financial statement audit reporting. They cite lack of materiality as the basis for their position. The full text of management's response is included as Appendix VI to this report.

Our evaluation of the overall impact of the individual internal control weaknesses identified by the audit was based on definitions promulgated by the American Institute of Certified Public Accountants, Office of Management and Budget (OMB) and the General Accounting Office. Materiality is not a factor in the assessment of a reportable condition.

Materiality becomes a factor when determining whether a reportable condition represents a material weakness in internal control. We have not, in this report, asserted the existence of a material weakness related to the accounting for debt recovery transactions. This report does not provide a basis for determining the materiality of errors related to any control weaknesses.

Our review did not include comprehensive identification and testing of all debt recovery transactions and related controls. The non-random case selection technique used to identify at-risk transactions consisted of a subjective examination of individual debts. Accordingly, no conclusions can be drawn concerning the adequacy of controls not specifically discussed in this report and no projections or inferences concerning the monetary impact of errors should be made.

INTRODUCTION

This report presents the results of the Office of Inspector General's (OIG) review of internal control over financial accounting for debt recoveries at the Railroad Retirement Board (RRB).

Background

The RRB is an independent agency in the executive branch of the Federal government. The RRB administers the health and welfare provisions of the Railroad Retirement Act (RRA) which provides retirement-survivor benefits for eligible railroad employees, their spouses, widows and other survivors. During FY 1999, approximately 748,000 annuitants received benefits totaling \$8.25 billion under the RRA.

The RRB also administers the Railroad Unemployment Insurance Act (RUIA) which provides unemployment and sickness insurance to workers in the rail industry. During FY 1999, the RRB paid \$70.6 million to the 13,000 individuals qualifying for unemployment benefits and the 21,000 individuals qualifying for sickness benefits under the RUIA.

In FY 1999, the RRB established new receivables due from the public totaling \$80.9 million including principle and interest. As of September 30, 1999, the agency reported a pending balance of \$53.1 million in uncollected receivables; debts in which collection is considered doubtful comprise 29% of the total.

The debt recovery process begins with the recognition that a benefit overpayment has occurred. In many cases, notice of an event that will affect the benefit payment amount is received after-the-fact. If the corrected rate is lower than the amount actually paid in the past, the beneficiary will have been overpaid. The agency then recognizes a debt in its financial records and takes action to collect the overpayment.

Program debt typically arises when a change in an annuitant's personal or employment status occurs. Events that take place after benefits have been awarded, such as death, divorce, remarriage and return to employment, may affect eligibility or necessitate re-computation of the benefit payment amount.

Concurrent entitlement to Social Security benefits, workers' compensation or other retirement benefits may also impact eligibility and/or benefit levels.

The Bureau of Fiscal Operations (BFO) has primary responsibility for the RRB's accounting operations. BFO's Debt Recovery Division (DRD) has overall responsibility for the RRB's debt collection activities including monitoring the collection status of pending debt and pursuing delinquent debtors.

The Program Accounts Receivable (PAR) system is a mainframe computer application that supports the agency's debt recovery operations. It contains the detailed history of each debt recognized by the RRB including the cause, amount, collections, outstanding balance and final disposition. Although DRD has administrative responsibility for the PAR system, the majority of transactions recorded in that system are initiated elsewhere.

The PAR system receives information about debt-related transactions through both manual and automated processes. Automated systems are used to record debt recovery information that is received from commercial bank lockboxes, the U.S. Department of the Treasury (Treasury) and agency systems that process common or recurring debt-related transactions. Manual processes are used to enter transactions that cannot be processed by an automated system.

The RRB's general ledger summarizes the debt recovery transactions that have been recorded in detail in the PAR system. The general ledger is a collection of all agency financial accounts, and supports the RRB's financial management and reporting. BFO's Accounting, Budget, and Financial Systems Division maintains the general ledger. The Federal Financial System (FFS) is the mainframe computer application that supports general ledger accounting activity.

Internal control is an integral component of an organization's management that provides reasonable assurance concerning the effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. Pursuant to the provisions of the Federal Managers' Financial Integrity Act of 1982, the General Accounting Office has issued standards for internal control in government. These standards provide the overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges.

The RRB's strategic plan states that "we will safeguard our customers' trust funds through prudent stewardship" as the agency's second strategic objective in meeting its overall goal of providing excellent customer service. The factors that impact debt collection have a direct relationship to RRB trust fund integrity. This audit addresses these important areas of management performance.

Objective, Scope and Methodology

The objective of this review was to assess the adequacy of financial accounting controls related to debt recoveries during FY 2000. In order to achieve this objective, we obtained computer files detailing all debt established during FY 1998 and related overpayment letters. We chose debt established in FY 1998 as a basis for this audit in order to include the full range of both debt recognition and debt recovery transactions that occur over time.

We performed substantive tests of debt recovery transactions selected on a non-random basis to identify errors that might indicate the existence of control weaknesses. For those debt recovery activities that appeared to be vulnerable to errors, we:

- examined prior agency risk assessments;
- evaluated the internal control structure in effect during FY 2000;
- reviewed applicable agency policy and procedure; and
- interviewed management and staff in BFO, the Office of Programs and the Bureau of Information Services.

Our review did not include comprehensive identification and testing of all debt recovery transactions and related controls. The non-random case selection technique used to identify at-risk transactions consisted of a subjective examination of individual debts. We considered factors such as cause of overpayment, magnitude of the debt and repayment status in assessing risk at the transaction level. Accordingly, no conclusions can be drawn concerning the adequacy of controls not specifically discussed in this report and no projections or inferences concerning the monetary impact of errors should be made.

Our work was performed in accordance with generally accepted government auditing standards as applicable to the audit objectives. Fieldwork was conducted at RRB headquarters during October 1999 through August 2000.

FINDINGS AND RECOMMENDATIONS

Our review determined that internal control over debt recovery accounting is not adequate to ensure the reliability of financial reporting and the safeguarding of accounts receivable. The following sections of this report summarize the basis for our opinion and present a detailed discussion of our findings concerning specific errors, omissions and internal control weaknesses identified during the audit. The full text of management's response to our findings and recommendations is presented in Appendix VI to this report.

Internal Control Is Not Adequate

Internal control is not adequate to provide reasonable assurance that debt recovery transactions are recorded timely and accurately.

Internal control should provide reasonable assurance that the objectives of the agency are being achieved in the following categories:

- effectiveness and efficiency of operations;
- reliability of financial reporting including reports on budget execution, financial statements, and other reports for internal and external use; and
- compliance with applicable laws and regulations.

Internal control should be designed to provide reasonable assurance that agency assets are safeguarded from unauthorized acquisition, use or disposition through prevention or prompt detection.

During our review, we observed the following errors that were neither prevented nor disclosed by existing controls:

- duplicate debt entries;
- duplicate posting of recoveries;
- recoveries not credited to debtor accounts;
- delayed recording of RUIA recoveries; and

- abnormal balances in the general ledger unapplied cash accounts.

We also identified the following weaknesses in the internal control structure:

- controlling and clearing accounts are not used to summarize benefit payment operations and reconcile detailed transactions recorded in the PAR system with other summary information in the general ledger;
- the general ledger unapplied cash account is not subject to analysis or reconciliation when balances are abnormal;
- benefits can be erroneously credited as debt recoveries in the PAR system;
- unauthorized transactions can be entered into the PAR system; and
- recoveries made by benefit withholding are not verified by the benefit payment systems prior to recording.

The present weaknesses in the internal control structure exist because agency management did not recognize all of the potential control risks and, as a result, did not develop appropriate controls to prevent or detect them.

Undetected errors adversely impact the RRB's ability to collect debts and report on debt collection activities. As a result, the agency is vulnerable to fraud from unauthorized transactions. In addition, management does not have sufficient information to determine (1) whether (or what) corrective action will be cost-effective and (2) the financial reporting impact of errors.

Some of the errors that we identified during the audit were related to weaknesses that are inherent to a control environment in which:

- transaction processing responsibilities cross organizational lines;
- manual processes are still required for some classes of transactions;

- both manual and automated processes can initiate the same transactions; and
- automated payment and debt recovery accounting systems do not share data.

Our audit was not intended to identify all of the weaknesses that may exist in the design or operation of internal control over debt recovery accounting. Accordingly, a comprehensive management review of the control environment is indicated. Because debt recovery processing crosses organizational lines, such a review will require participation of the various agency components that share these responsibilities.

This audit report contains recommendations for corrective action intended to address the specific errors and design weaknesses that were identified by the audit. These recommendations are directed to the organizational units currently responsible for that processing activity. However, implementation of these recommendations will also require cross-organizational cooperation to ensure the efficiency and cost-effectiveness of corrective action.

Recommendation

We recommend that BFO organize a cross-organizational workgroup to study the debt recovery control environment and make recommendations for improvement (Recommendation #1).

Management's Response

BFO concurs with the recommendation and has agreed to organize a cross-organizational workgroup.

Discrepancies Between Summary and Detail Records

Discrepancies exist between the general ledger, the PAR system and the several automated systems supporting benefit payment operations.

Transactions should be recorded accurately and timely in order to maintain their relevance and value to management in controlling operations and making decisions. This standard applies to the entire life cycle of a transaction from the initiation and authorization through its final classification in the summary accounting records.

Part of the FFS mainframe computer application, the general ledger supports the RRB's financial management and reporting activities including preparation of the agency's annual financial statements. The general ledger summarizes the transactions that are detailed in the PAR system and the systems that support benefit payment operations in the Office of Programs.

The PAR system, a mainframe computer application, supports the RRB's debt recovery operations. It contains individual records for each debt recognized by the agency. The PAR system records the history of each debt from the time it is recognized until it is recovered, waived or written-off as uncollectible. The benefit payment activities that originate in the Office of Programs are supported by automated systems that detail the benefit entitlement and payment histories of each RRA and RUIA beneficiary.

Discrepancies between summary and detail records occur because:

- the general ledger does not include accounts that provide a basis for identification and reconciliation of discrepancies between amounts recorded on a summary basis in the general ledger with the detailed transaction records (except cash receipts from the public);
- the general ledger RRA and RUIA unapplied cash accounts (cash receipts from the general public) provide a basis for reconciliation of discrepancies, but such reconciliations are not part of current accounting procedure; and

- the same transaction may be recorded with different dates in several automated systems including the general ledger, the PAR system and the Office of Programs' benefit payment systems.

As a result, errors in recording debt recovery transactions may remain undetected, and the general ledger may not accurately summarize the results of individual debt recovery transactions.

The three weaknesses in general ledger accounting control identified by the audit are discussed in detail in the following sections of this report along with recommendations for specific corrective action.

Controlling and Clearing Accounts Are Not Used

The RRB does not use controlling and clearing accounts to summarize and reconcile all debt-related transactions in the general ledger. As a result, errors in the manual or automated processing of detailed transactions that affect general ledger accounts may not be identified and corrected.

A **controlling account** is a general ledger account that reflects the aggregate balance of related subsidiary ledger accounts. A **subsidiary ledger** is a supporting ledger of related accounts that, in total, equals the controlling account appearing in the **general ledger**.

At the present time, the agency's benefit payment system (effectively a subsidiary ledger) summarizes only that portion of the benefit payment operation resulting in a cash disbursement. The general ledger records the cash disbursed as a decrease in the cash account and an increase in the benefit expense account.

The configuration of the accounts in the general ledger does not include a controlling account that summarizes the total amount of benefits payable to annuitants, the funds actually disbursed in cash, and the amounts withheld to satisfy outstanding overpayments.

A **clearing account** is a temporary general ledger account that contains costs (or other amounts) that will ultimately be transferred to another account. For example, a clearing account for debt recoveries made by benefit withholding would record the aggregate total of benefits withheld and compare it with the total of all such amounts applied to debtor accounts receivable. The normal balance in this account would be zero. Differences between the two recorded amounts, resulting in a positive or negative balance, would indicate incomplete or inaccurate transactions.

At the present time, the general ledger does not include clearing accounts that would provide a basis for reconciliation of amounts recorded as debt recoveries in the PAR system versus the supporting detailed records in other agency systems. As discussed later in this report, errors do occur and the resulting discrepancies are not identified for correction.

As a result of this audit, BFO has begun the process of identifying automation changes that will facilitate the implementation of controlling and clearing accounts.

Recommendation

We recommend that BFO:

- establish a controlling account for benefit payments in the general ledger and procedures for its periodic review and reconciliation (Recommendation #2); and
- establish clearing accounts for each type of debt recovery transaction and procedures for the periodic review and reconciliation of each such account (Recommendation #3).

Management's Response

BFO has begun to implement additional preventative internal control measures to ensure that each of the components of benefit payments is accurately recorded in the general ledger. In addition, they have already established a clearing account for unapplied cash and will develop a clearing account for benefit payments withheld. BFO is also developing an automated program to summarize debt recovery cash transactions that are posted to FFS and the PAR system. Management plans to defer further action until the effect of these initiatives has been evaluated by the cross-organizational workgroup.

Abnormal Balances in Unapplied Cash Accounts

The RRB's unapplied cash accounts periodically have abnormal balances. An abnormal balance indicates that more cash may have been applied to debtor accounts than has actually been received. In effect, both the RRA and RUIA accounts appear to have been overdrawn in the past. A summary of RRA and RUIA unapplied cash balances is presented in Appendix I.

The RRB's general ledger includes an account titled unapplied cash to which cash receipts are credited when initially received. Separate accounts are maintained for RRA and RUIA receivables. As cash is received, BFO credits one of the unapplied cash accounts in the general ledger. Then, through a process independent of the general ledger, cash receipts are posted to individual debtor accounts in the PAR system.

On a monthly basis, the total of all cash receipts posted to the PAR system is recorded in the general ledger as a reduction to both the accounts receivable and the unapplied cash accounts. An abnormal balance in the unapplied cash account occurs when total reductions exceed the total cash recorded in the account.

Although an abnormal balance in unapplied cash is a warning signal that more cash may have been applied to debtor accounts than has actually been received, other types of bookkeeping and accounting errors can have the same effect. A detailed account analysis is required to identify the accounting problems and control weaknesses that result in abnormal balances.

In the past, the abnormal balances in unapplied cash were not investigated because the unapplied cash accounts were not designed to serve as an internal control. Accordingly, current BFO procedure does not require review, reconciliation or investigation of abnormal balances in those accounts. As a result, the reasons for the overdrawn status of these accounts are unknown and the errors that caused it remain uncorrected.

As a result of this audit, BFO has begun the process of identifying automation changes that will facilitate the future analysis of the general ledger unapplied cash accounts.

Recommendation

We recommend that BFO analyze the abnormal balances in the existing unapplied cash accounts, and make adjustments as necessary (Recommendation #4).

Management's Response

BFO concurs with the audit finding and plans to adjust the unapplied cash accounts as necessary.

Unsynchronized Transactions

The PAR system and the general ledger do not always record debt recovery transactions on the same dates. This lack of synchronization creates unnecessary timing differences between the PAR system and the general ledger.

Debt recoveries are credited to individual debtor accounts in the PAR system using the date that the records are updated. As a result, transaction dates recorded in the PAR system do not necessarily correspond with the date recovery is actually made.

In the current accounting environment, the PAR system reports aggregate debt recoveries to the general ledger on a monthly basis as determined by the transaction dates recorded in the PAR system. Delays in posting transactions to the PAR system result in delays in posting to the general ledger.

In the preceding section of this report, we recommended that the RRB implement general ledger controlling and clearing accounts that would provide a comparison of amounts received versus amounts credited to debtor accounts. Timing differences adversely affect the usefulness of controlling and clearing accounts because they create discrepancies that will complicate the account reconciliation process.

Recommendation

We recommend that BFO request programming changes as necessary to ensure that PAR system transactions are synchronized with transactions recorded in the general ledger (Recommendation #5).

Management's Response

BFO concurs with the audit finding and has initiated programming changes to record deposits in the PAR system using the date of the cash receipt document.

Errors Originating Outside of BFO

The present system of internal control does not provide adequate assurance that debt recovery transactions originating outside of BFO will be prevented or detected.

In the preceding sections of this report, we discussed weaknesses in the agency's system of accounting controls that limit BFO's ability to ensure the accurate and timely recording of debt recovery transactions in the general ledger. In this section, we present errors and inconsistencies in debt recovery transactions that originated in the Office of Programs and the Bureau of Information Services (BIS).

As previously stated, transactions should be recorded accurately and timely in order to maintain their relevance and value to management in controlling operations and making decisions. The present control environment does not include controls that will:

- ensure that returned benefit payments are credited to debtor accounts in the PAR system, or
- prevent benefit payments from being erroneously credited as debt recoveries.

In addition, accounting practices in the Office of Programs weaken the control environment:

- overpayments are not consistently established at the full amount;
- multiple debts are sometimes created from a single overpayment; and
- recoveries of RUIA overpayments from RRA annuities are not promptly credited to debtor accounts.

As a result, the PAR system may not accurately report the status of individual accounts receivable. Inaccurate information diminishes the value of the PAR system in supporting agency debt collection activities.

The Office of Programs and BIS are the points of original entry for certain debt recovery transactions. As such, they have significant internal control responsibilities.

Claims examiners in the Office of Programs:

- calculate overpayments;
- establish debt records in the PAR system;
- investigate cash receipts that are not applied to a debtor account through automated processes, to determine whether a debt should be established or the funds returned to the remitter;
- withhold benefit payments in full or partial satisfaction of outstanding debts; and
- correct previously established debt records.

BIS is responsible for the programming, operation and maintenance of the hardware and software that comprise the RRB's information systems environment which includes processing returned payment data received in electronic formats.

The five weaknesses in the control of debt recovery transactions that originate outside of BFO are described in detail in the following sections of this report, along with recommendations for specific corrective action.

Returned Benefit Payments Not Credited To The PAR System

Controls do not exist to ensure that returned benefit payments are credited to individual debtor accounts in the PAR system.

Our review identified cases in which returned benefit payments had not been credited to individual debtor records. These omissions occurred because the computer file created for use in updating the various automated systems had been erased by another program and was no longer available. The premature erasure was caused by automated job scheduling procedures that did not adequately take into account the unscheduled nature of Treasury's transmissions.

Treasury advises the RRB of returned benefit payments on a daily basis via an electronically transmitted data file. This data is used to update several of the RRB's automated systems, including the PAR system.

BIS, the organizational unit responsible for mainframe computer operations has made job scheduling changes that are expected to ensure the future reliability of this process. These changes were made incidental to BIS's review of the timeliness of updates to a related system and not as a result of established internal control.

Although the job scheduling changes were made in March 2000, agency management did not initiate a mass identification of missed payments and correction to the related debtor accounts. Consequently, our audit identified payments that had not been credited to a debtor account.

Our audit identified nine payments totaling \$7,565.05 that had not been credited to the related account receivable. In one case, a cash payment had been made and correction of the account resulted in a refund.¹ These errors were identified through an examination of cases selected on non-random basis from overpayments caused by death. Appendix II presents a listing of the exceptions identified by the audit.

As a result of our audit, BFO, in cooperation with BIS, has initiated the process of correcting current accounts and developing controls designed to disclose future errors promptly.

As discussed previously, the RRB's accounting system does not employ controlling and clearing accounts to reconcile PAR system activity with the general ledger. Periodic reconciliation of such accounts could have disclosed these errors.

Although BIS is the point of original entry for these transactions, BFO has agreed to assume responsibility for corrective action.

¹ Benefits disbursed after the death of an annuitant had been repaid by a family member prior to initiation of the debt recovery process. The reclamation process resulted in a duplicate recovery. Refund of the duplicate payment was delayed approximately 18 months because the returned payment was not processed promptly.

Recommendation

We recommend that BFO:

- identify and correct cases in which returned payments were not credited to the related account receivable (Recommendation #6); and
- establish controls designed to ensure that all returned payments are credited to the proper account (Recommendation #7).

Management's Response

BFO concurs with the audit findings and has begun to take the recommended corrective action.

Benefit Payments Can Be Erroneously Credited As Recoveries

Controls do not exist that will prevent or detect overpayment recoveries erroneously attributed to the withholding of RRA benefit payments.

The RRB may withhold benefit payments in order to recover RRA and RUIA overpayments. Our examination of internal controls disclosed that, when debt recovery is attributed to benefit withholding, the current control structure permits processing of transactions that are unsupported by any benefit payment determination or operation. There are several weak points in the transaction processing environment that contribute to this problem:

- the RRB's benefit payment system does not communicate directly with the PAR system;
- the PAR system may be advised of benefit withholding by any of several automated and manual processes;
- there are no controls to ensure that only valid recoveries withheld from benefits are entered to the PAR system; and
- there are no controls to ensure that valid recoveries withheld from benefits are entered only once to the PAR system.

As discussed previously, the RRB's accounting system does not use controlling and clearing accounts to reconcile PAR system activity with the benefit payment systems. Instead, the RRB recognizes benefit expense directly whenever the PAR system reports a recovery by benefit withholding. This is true whether or not benefits have actually been withheld.

This control weakness was identified through an examination of duplicate debt entries in the PAR system that resulted from procedural errors in the Office of Programs. A detailed discussion of these cases is presented in Appendix III.

Although identified through an examination of errors, this weakness increases the agency's risk of loss from unauthorized transactions as discussed on page 25.

Recommendation

We recommend that the Office of Programs develop controls to ensure that only benefits actually withheld can be credited as debt recoveries and that amounts withheld can be credited to the PAR system only once (Recommendation #8).

Management's Response

The Office of Programs and BFO have agreed to refer recommendation #8 to the cross-organizational workgroup that will be established in response to recommendation #1. The workgroup will review the issues and recommend a course of action.

RUIA Overpayments Recovered From RRA Annuities Are Not Credited Timely

Overpayments incurred by railroad workers under the RUIA program may be recovered from benefits awarded under the RRA after retirement. Current procedure requires that an RUIA debt be recovered in full before any recoveries made by the withholding of RRA benefits are credited to the debtors' accounts in the PAR system. As a result, the accounts receivable system does not accurately reflect the current status of these debts.

Recovery of an RUIA debt by withholding of the RRA annuity may take only a few months or many years depending on the magnitude of the debt, the amount of the debtor's RRA annuity and whether the annuity is subject to full or partial withholding. The audit identified one case in which the expected recovery period was 17 years.

The Office of Program, with the concurrence of BFO, adopted this procedure in order to avoid the repetitive, labor intensive, manual process that is required to process these recoveries into the accounting system. Currently, when RRA benefits are withheld to recover an RUIA overpayment, a claims examiner in the Office of Programs must complete a paper form detailing the amount and source of recovery. The form is then sent to DRD for manual data entry into the PAR system. In order to achieve timely recording of the recoveries, this process would have to be scheduled and executed each month for each annuity payment withheld in satisfaction of an RUIA overpayment.

During our audit, we identified cases in which the Office of Programs, in accordance with current policy, delayed recording RUIA debt recoveries until full recovery from an RRA annuity had been completed. A list of the cases identified during the audit is presented in Appendix IV to illustrate the extent of delays associated with this practice.

Management in the Office of Programs and BFO have discussed this audit finding and concluded that the most effective and efficient means of ensuring timely recording is to automate the process. Automation would eliminate the burden of paperwork on both BFO and the Office of Programs.

Recommendation

We recommend that the Office of Programs develop policies, procedures and systems to ensure timely and accurate recording of RUIA recoveries (Recommendation #9).

Management's Response

The Office of Programs and BFO have agreed to refer recommendation #9 to the cross-organizational workgroup that will be established in response to recommendation #1. The workgroup will review the issues and recommend a course of action.

Overpayments Are Not Consistently Established At The Full Amount

During our review, we identified debts that had been recorded on the PAR system at less than the full amount. This error occurs when a pending benefit accrual is used to reduce the debt before it is established on the PAR system.

Current procedure calls for claims examiners to establish overpayments at the full amount before reduction for pending benefit accruals. However, we identified cases in which that procedure had not been followed.

When debts are not initially established in the full amount, the PAR system does not present a complete history of all relevant transactions. As a result, claims examiners cannot rely on the PAR system without consulting other systems or reviewing the supporting paper documentation in the claim folder. Since claims examiners cannot rely on the PAR system alone, it is difficult to ensure that benefit payments withheld will be used only once to collect a debt. During the audit, we identified a case in which a benefit payment was posted twice to recover a single debt, apparently because the debt had been established net of the pending accrual.

Under the current accounting system, when debts are established net of pending benefit accruals, the total amount of debt incurred and the related recoveries are both understated, the net effect on the general ledger is zero. However, if, as we recommended earlier in this report, controlling and clearing accounts are implemented, recording debts net of pending benefit payments would have the additional impact of creating an imbalance in the related clearing account.

Clearing accounts monitor transactions with the expectation that inflows will equal outflows. Any imbalances indicate that errors have occurred. The clearing account for benefits withheld in satisfaction of a debt would compare benefits withheld per the Office of Programs detail records with benefit payments applied to individual debtor accounts in the PAR system. Debts established net of accruals would impact the clearing account as errors because the Office of Programs' record would report benefits withheld but the PAR system would not.

Examples of debts established on the PAR system net of benefit accruals are presented in Appendix V.

Recommendation

We recommend that the Office of Programs implement controls to ensure that all overpayments are initially established in the PAR system at the full amount (Recommendation #10).

Management's Response

The Office of Programs concurs with the audit finding and has initiated changes designed to ensure that all overpayments are initially established in the PAR system at the full amount.

Multiple Debts From A Single Overpayment

Certain overpayments that result from beneficiary entitlement to Social Security benefits create two PAR system debts instead of one. This accounting treatment is the result of limitations imposed by the automated system that processes RRA benefit adjustments related to Social Security entitlement.

The RRB is required to reduce RRA benefit payments for concurrent entitlement to Social Security benefits. In most cases, the Social Security Administration (SSA) certifies these benefits to the RRB so that a single check for both benefits can be issued.

Overpayments routinely occur when Social Security benefits are payable retroactively for earlier periods during which unreduced RRA benefits have already been paid. In most cases, the RRB recovers the RRA overpayment from the accrued Social Security benefits that have not yet been paid. The automated system that processes Social Security entitlements establishes the debt on the PAR system and records full recovery.

When the RRA overpayment exceeds the accrued Social Security benefits from which recovery can be made, the RRB establishes two debts on the PAR system. The first entry, created by the automated system, records the portion of the overpayment that can be fully recovered from the pending Social Security accrual. A second debt for the uncollected balance is established on the PAR system by a claims examiner in the Office of Programs.

The practice of establishing two debts from a single overpayment overstates the number of debts that arise from program operations and weakens the overall control environment by perpetuating reliance on manual processes. It also makes it difficult to determine the full amount and disposition of the debt without recourse to paper documentation. For example, the fully recovered portion of the overpayment may be archived while the balance, established as a separate account, remains uncollected. Archived debts are no longer available for viewing on-line.

Recommendation

We recommend that the Office of Programs request programming changes to eliminate the practice of splitting a single overpayment into two PAR system debt entries (Recommendation #11).

Management's Response

The Office of Programs has agreed to refer recommendation #11 to the cross-organizational workgroup that will be established in response to recommendation #1. The workgroup will review the issues and recommend a course of action.

EXPOSURE TO FRAUD

Current internal control is not adequate to prevent unauthorized entry of transactions to the PAR system.

Transactions and other significant events should be authorized and executed only by persons acting within the scope of their authority. Authorization is the principal means by which an organization ensures that only valid transactions to exchange, transfer, use or commit resources are initiated or entered into.

This control weakness exists because management did not recognize the existence of risk from unauthorized debt recovery transactions. Management has not recognized accounts receivable as a valuable asset that might be converted for personal gain. As a result, accounts receivable, are not adequately safeguarded against loss.

The risk of loss from unauthorized transactions is increased by a related weakness in the design of internal control that permits processing of debt recovery transactions that are unsupported by any benefit payment determination or operation. This weakness was discussed in detail on page 19.

For reasons of security, the details of the audit procedures that caused the auditors to draw this conclusion will be communicated to agency management separately.

Recommendation

We recommend that the Office of Programs implement controls designed to prevent unauthorized transactions (Recommendation #12).

Management's Response

The Office of Programs concurs with the audit finding and is in the process of implementing changes in procedure that would replace the present paper-based system with electronic transmission of information in a password protected environment.

REPORTABLE CONDITION

The errors, omissions and weaknesses in the RRB's system of internal control over debt recoveries constitute a reportable condition for purposes of financial statement audit reporting.

A reportable condition is a deficiency in the design of internal control that could adversely affect the RRB's ability to record, process, summarize, and report financial data consistent with assertions of management in the financial statements.

The design of internal control for debt recovery accounting is deficient because of the:

- failure to perform tasks that are part of internal control such as establishment, review and reconciliation of controlling accounts;
- absence of appropriate reviews of systems output as evidenced by the omission of returned payments from the PAR system; and
- inadequate provision for safeguarding of assets as evidenced by the agency's exposure to fraud from unauthorized transactions.

In addition, the present internal control environment does not provide management with sufficient information concerning the number and value of non-conforming transactions to provide the basis for an evaluation of potential financial impact.

On page 12 of this report, we made recommendations for implementation of controlling and clearing accounts. These recommendations will address the major deficiencies in the design of internal control cited above. Accordingly, we make no further recommendations.

Management's Response

In their joint response, the responsible officials in the Bureaus of Fiscal Operations, Information Services and the Office of Programs disagreed with the OIG's assessment of a reportable condition. They cited lack of materiality as the basis for their position.

Office of Audit Comments on the Management Response

Reportable conditions, as defined in OMB Bulletin 98-08, "Audit Requirements for Federal Financial Statements," are "matters coming to the auditor's attention that, in the auditor's judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control, that could adversely affect the organization's ability to meet" its internal control objectives.

OMB Bulletin 98-08 defines the agency's control objective concerning the reliability of financial reporting:

"to provide reasonable assurance that ... transactions are properly recorded, processed, and summarized to permit the preparation of the Principal Statements and Required Supplementary Stewardship Information in accordance with Federal accounting standards..."

In our opinion, the control weaknesses identified by the audit:

1. are significant deficiencies in the design of internal control, and
2. could adversely impact the RRB's ability to provide reasonable assurance that debt recovery transactions are properly recorded, processed and summarized to permit the preparation of the financial statements.

Materiality becomes a factor when determining whether a reportable condition also represents a material weakness in internal control. We have not asserted the existence of a material weakness related to the accounting for debt recovery transactions in this report.

As previously stated, the present control environment does not provide management with sufficient information concerning the number and value of non-conforming transactions to provide the basis for an evaluation of potential financial impact. Since this report does not provide a basis for determining the materiality of errors resulting from the control weaknesses identified during our audit, we cannot agree with management's estimate of monetary impact.

APPENDICES WILL BE PROVIDED UPON REQUEST.

